INDEX

CITATIONS

In the Supreme Court of the United States

October Term, 1942

No. 660

Moline Properties, Inc., petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 16–22) is reported in 45 B. T. A. 647. The opinion of the Circuit Court of Appeals (R. 89–91) is reported in 131 F. 2d 388.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 7, 1942 (R. 91). Petition for rehearing was denied December 11, 1942 (R. 98). The petition for a writ of certiorari was filed on January 18, 1943, and was granted on March 8, 1943. The jurisdiction of this Court

rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the profits realized by the taxpayer corporation should be included in its taxable gross income or whether, as the taxpayer contends, the corporate entity should be disregarded and its income attributed to its sole stockholder.

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 13. TAX ON CORPORATIONS.
>
> (a) *Rate of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation, * * *.
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> * * * * *
>
> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * sales, * * *.
>
> * * * * *
>
> SEC. 52. CORPORATION RETURNS.
>
> Every corporation subject to taxation under this title shall make a return, * * *.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 13. NORMAL TAX ON CORPORATIONS.
>
> * * * * *
>
> (b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the normal-tax net income

of every corporation, a normal tax as follows:

* * * * *

The provisions of Sections 22 (a) and 52 of the Revenue Act of 1936, *supra,* are identical with those set forth above.

STATEMENT

This case involves the taxpayer's income tax liability for the years 1935 and 1936. The facts as found by the Board of Tax Appeals (R. 17–19) may be summarized as follows:

The taxpayer is a corporation, organized under the laws of Florida in 1928. Its president and sole stockholder, with the exception of holders of qualifying shares, has at all times been Uly O. Thompson. (R. 17.)

On August 17, 1920, Thompson acquired certain real estate in Florida, which he mortgaged in 1923 for $20,000. On March 18, 1926, he gave a second mortgage on this property to Miami Beach Bank and Trust Company, hereinafter referred to as Miami, to secure an additional loan of $20,000. (R. 17.)

Subsequently, Thompson failed to pay the taxes on the property and was told by the second mortgagee that the taxes would have to be paid to prevent the loss of the property. It was then proposed and agreed that the Bank of Bay Biscayne, hereinafter referred to as Biscayne, with which Miami was affiliated, would lend $6,750 to

pay the accumulated taxes and that Thompson in return would authorize Biscayne to organize a corporation to hold title to the property which was identified as "Block 77." (R. 17, 36.) The stock of the corporation was to be issued to Thompson. It would then be pledged as collateral for the loan and placed by Thompson in a voting trust to be controlled by the bank. The trust would cease either on payment of the loan or sale of the pledged stock. (R. 17.) Pursuant to this agreement the taxpayer was organized and its stock, with the exception of qualifying shares, issued to Thompson. On June 5, 1928, Thompson conveyed Block 77 to the taxpayer and executed the voting trust agreement. The taxpayer assumed and agreed to pay the two mortgages as a part of the purchase price. (R. 17–18.)

Biscayne closed in 1930 and its powers under the voting trust were thereafter exercised by the bank liquidator (R. 18). The debt of \$6,750 owed to Biscayne was settled by the taxpayer during 1933 (R. 18). In that year the stock of the taxpayer which had been pledged and held under the voting trust was returned to Thompson (R. 18). On July 29, 1933, the taxpayer discharged and satisfied the two mortgages which were outstanding on the property owned by it, each in the amount of \$20,000. Funds for these discharges were obtained by Thompson through a loan which he negotiated with the National Investment Hold-

ings, Inc. This loan was secured by a mortgage on a portion of the property in question. (R. 18.)

Sometime during the period that the voting trust was in effect a suit was instituted to remove certain restrictions imposed on Block 77 by a prior deed. Of the expenses connected with this suit, $4,005.39 was paid by Thompson in 1933 and subsequent years. The taxpayer was also required to defend a certain condemnation proceeding during this period. (R. 18.)

The taxpayer on October 1, 1929, purchased from Biscayne a note of Thompson's, together with a real-estate mortgage securing it, in the amount of $43,000, on which interest of $9,703.14 was due, at its par value plus accrued interest. The taxpayer gave its note for the purchase price, securing it with Thompson's mortgage, which it received on the purchase of the note. (R. 18.)

The taxpayer's property was sold in three separate parcels, one in each of the years 1934, 1935, and 1936 (R. 19). The debt owed to National was paid in 1936 from the proceeds of the sales (R. 18). The proceeds of the sales were received by Thompson, who deposited them in his bank account (R. 19).

The sales made in 1934 and 1935 were reported in the income tax returns of the taxpayer. A loss was reported for 1934 and a gain for 1935. Subsequently Thompson was advised by his auditor that due to the circumstances of the tax-

payer's organization, these sales might be reported by Thompson and a claim for refund of tax accordingly filed on the taxpayer's behalf for 1935. In a delinquent return filed in 1938, Thompson reported the 1935 gain as his individual gain. Gain on the 1936 sale was reported by Thompson. (R. 19.)

The taxpayer did not keep books of account or maintain a bank account. It owned no assets other than the real estate described above. It leased a portion of its properties in 1934 for parking lot purposes, from which it received rental of $1,000. Thompson owned other real property in Miami, title to which was in his name individually. (R. 19.)

During 1934 and a part of 1935 Thompson was a circuit judge of the State of Florida. His salary was his principal source of income. When his office was abolished in 1935 he returned to the practice of law. (R. 19.)

The taxpayer has not been dissolved. However, it has transacted no business since the sale of its property in 1936. (R. 19.)

The Commissioner ruled that the profits realized by the taxpayer in 1935 and 1936 must be included in its taxable income, but the Board of Tax Appeals reversed, holding that the existence of the taxpayer must be disregarded for tax purposes. (R. 19–22.) The Circuit Court of Appeals in turn reversed the Board and held that Thompson having voluntarily chosen to organize

taxpayer to conduct certain business affairs, neither he nor the taxpayer could disavow the corporate entity in order to obtain a tax advantage thereby. (R. 91.)

SUMMARY OF ARGUMENT

Under Section 13 of the Revenue Acts of 1934 and 1936 a tax is levied on the income of every corporation. No exception is made with respect to wholly-owned realty corporations merely because they transact little business. For purposes of the capital stock tax Congress distinguishes between corporations engaged in business and those that are not so engaged. Failure to make such a distinction in the income tax provisions indicates that the tax is levied on the income of every corporation with the intent that all corporations should be subject thereto. Reinforcing this view is the fact that when Congress has wished to withdraw corporations from the operation of Section 13 special provision has been made. Thus it is clear that Congress intended a tax to be levied on the income of every corporation whatever the nature of its activity or the ownership of its stock. This broad construction of Section 13 is in harmony with this Court's decisions in *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415, and *Higgins* v. *Smith*, 308 U. S. 473.

The result is that one who chooses to do business as a corporation must pay the tax levied by Section 13. Nor is the case altered by conten-

tion that the corporation here involved is to be regarded as a mere agent. The decision to do business in corporate form with the corporation held out as the principal means that the burdens of doing business in that fashion must be borne by the corporation. Since the taxpayer was created for the purpose of receiving ownership of property, and that property was sold as its property, the Commissioner is authorized by Section 13 to assess a tax against it on gain from that sale. Any other result would require repudiation of the decision in *Burnet* v. *Commonwealth Imp. Co., supra*, and the statements in *Higgins* v. *Smith, supra.*

As a matter of fact, the taxpayer did not in fact occupy the role of an agent. It was rather organized for a recognized business purpose. It was intended to, and did in fact, function as an entity distinct from its stockholder. Even on the legal principle contended for by the taxpayer, therefore, the tax was properly imposed.

ARGUMENT

NEITHER THE INSUBSTANTIAL CHARACTER OF ITS FUNCTIONS NOR THE FACT IT HAS BUT ONE STOCKHOLDER WILL RELIEVE A CORPORATION FROM TAXATION ON ITS INCOME

The taxpayer was duly organized as a corporation under the laws of Florida in 1928 (R. 17). Subsequently it performed the business functions for which it was created and others as well. The

income in question resulted from the sale of realty owned by the corporation. Because the situation of its sole stockholder for the tax years in question, 1935 and 1936, was such that attributing this income to him rather than to the corporation would effect a tax saving,[1] this litigation developed. The taxpayer-corporation seeks a declaration that, by reason of the limited character of its activities and its relation with its sole stockholder, it is exempt from the tax levied by Section 13 of the Revenue Acts of 1934 and 1936, *supra*. The issue here, it must be noted, is whether the taxpayer may be subject to any tax under this section.

At the outset it may be observed that no question is here presented respecting general principles governing disregard of the corporate entity, if there be such.[2] Nor indeed does this case require decision as to when the corporate personality will be disregarded in tax cases generally. The taxpayer's contention raises first the issue

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[1] Corporations do not have the benefit of the statutory provisions taxing only a percentage of long-term gains. Section 117 (a) of the Revenue Acts of 1934 and 1936. Moreover, they do not have the individual credit given by Section 25 (b) of the Revenue Acts of 1934 and 1936. For the tax situation of the sole stockholder for 1936, see pages 82-84 of the Record.

[2] For analytical treatment of the general problem see Latty, *The Corporate Entity as a Solvent of Legal Problems* (1936), 34 Mich. L. Rev. 597; Radin, *The Endless Problem of Corporate Personality* (1932), 32 Col. L. Rev. 643; Machen, *Corporate Personality* (1911), 24 Harv. L. Rev. 253, 347.

whether Congress intended to exempt corporations from the tax levied by Section 13 where their activity is limited and they have but one stockholder.

By the terms of Section 13 a tax is levied on the net income "of every corporation". Corporations exempted from the tax are specifically enumerated in Section 101 of the Revenue Acts of 1934 and 1936 and none of the exceptions embraces the taxpayer. Indeed, specific exemption of "Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses * * *" (Section 101 (14) of the Revenue Acts of 1934 and 1936) *only* when performing that function for an exempt corporation is persuasive by itself that otherwise a realty corporation is subject to the tax imposed by Section 13.

The language of Section 13, it may again be noted, lays a tax on the income of "every" corporation. Nor can this all-inclusive language be charged to legislative oversight or accident. For capital stock tax purposes Congress has long and consistently distinguished between corporations engaged in business and those that are not, with the tax levied on the former only.[3]

[3] Revenue Act of 1934:

SEC. 701. CAPITAL STOCK TAX.

(a) For each year ending June 30, beginning with the year ending June 30, 1934, there is hereby imposed

Indeed, the excise tax assessed against corporations prior to 1913, measured by their incomes, was levied only on corporations doing business and there had been considerable litigation on the question as to what corporate activity constitutes doing business. For representative decisions see *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503; *United States* v. *Emery*, 237 U. S. 28; and *McCoach* v. *Minehill Railway Co.*, 228 U. S. 295.

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upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

* * * * *

(c) The taxes imposed by this section shall not apply—

* * * * *

(3) to any domestic corporation in respect of the year ending June 30, 1934, if it did not carry on or do business during a part of the period from the date of the enactment of this Act to June 30, 1934, both dates inclusive; * * *

* * * * *

A similar provision appeared in Section 407 of the Revenue Act of 1916, c. 463, 39 Stat. 756; Section 1000 of the Revenue Act of 1918, c. 18, 40 Stat. 1057; Section 1000 of the Revenue Act of 1921, c. 136, 42 Stat. 227; Section 700 of the Revenue Act of 1924, c. 234, 43 Stat. 253; Section 105 of the Revenue Act of 1935, c. 829, 49 Stat. 1014; and Section 401 of the Revenue Act of 1936.

Representative of the Regulations defining the doing of business by corporations are Regulations 64, Articles 86 and 88, issued under the Revenue Act of 1934:

ART. 86. "*Not doing business*" *illustrated.*—Holding companies (as defined in article 88); * * * are not doing business.

* * * * *

Under these circumstances the Congressional decision in the Income Tax Act of 1913, c. 16, 38 Stat. 114, 166, and its successors, to levy a tax on the income of every corporation becomes doubly significant. Discarded for purposes of this tax was distinction between corporations on the basis of the nature of the corporate activity. Surely this is persuasive that Section 13 was designed by Congress to tax the income of every species of corporation. Significant in this connection as well are the requirements respecting the filing of returns. Under Section 52 of the Revenue Act of 1934, *supra*, a return is to be filed by *every* corporation subject to taxation under the act. Dovetailing with this section is the provision respecting returns by fiduciaries.[4] Such returns are required of fiduciaries for individuals, estates and trusts, but not

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> ART. 88. *Holding company defined.*—A holding company is one whose corporate powers are limited to the mere owning and holding of property and distribution of its avails, or one which, although incorporated for the purpose of doing business, has retired from the business for which it was organized and has reduced its activities to the mere ownership and holding of property, distributing its avails, and doing only such acts as are necessary to the maintenance of its corporate existence and the private management of its purely internal affairs.

A recent decision of this Court respecting corporate liability for the capital stock tax and thus turning on the question whether the corporation was engaged in business is *Magruder* v. *Washington, B. & A. Realty Corp.*, 316 U. S. 69.

[4] Section 142 of the Revenue Acts of 1934 and 1936.

for corporate beneficiaries, the reason, of course, being that all corporations, even the most passive beneficiaries, must themselves report their income.

The obvious proposition that Section 13 should be applied in accordance with its terms is further confirmed by the fact that on occasion Congress has withdrawn from its operation certain types of corporations. Illustrative are the provisions that appeared in the Revenue Acts of 1918 and 1921, taxing the income of personal service corporations directly to the stockholders thereof.[5] Provision has been made in various Revenue Acts for the filing of consolidated returns of affiliated corporations,[6] thus withdrawing these corporations from the scope of Section 13. Unless subsidiary corporations would otherwise have been subject to separate taxation on their income there would have been no point in such provision, none in its restriction to railroad corporations in Section 141 of the Revenue Act of 1934, and none in its general restoration in Section 141 of the Revenue Act of 1942, Public

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[5] Section 218 of the Revenue Acts of 1918 and 1921.

[6] Section 240 of the Revenue Acts of 1918, 1921, 1924, and 1926, c. 27, 44 Stat. 9; Section 141 of the Revenue Act of 1928, c. 852, 45 Stat. 791, and 1932, c. 209, 47 Stat. 169, provided for consolidated returns of affiliated corporations generally. Similar provision appears in Section 141 of the Internal Revenue Code, as amended by the Revenue Act of 1942. Public Law 753, 77th Cong., 2d Sess., Sec. 159.

Law 753, 77th Cong., 2d Sess. Such measures, under elementary interpretive rules, reflect clear legislative recognition of the broad sweep of Section 13—that it means what it says, i.e., that one of the prices of incorporation is payment of a federal tax on the corporate income.

The clarity of the language imposing the tax was certainly not calculated to breed litigation. In fact, only on rare occasions in this Court has it been argued that notwithstanding the clear expression of Section 13 to the contrary, there is a species of corporation of little activity and intimate association with the business of its sole stockholder which is not subject to income taxation. The argument was made in *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415, where this Court, without denying that the corporation had little vitality held that it was taxable on its income notwithstanding. In making that same con-

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[7] Reference may be made as well to certain other instances where Congress has dictated that the corporate veil be pierced. In Section 337 of the Revenue Act of 1936 as amended, 50 Stat. 822, the "undistributed Supplement P net income of a foreign personal holding company shall be included in the gross income of citizens or residents of the United States." Similar provision appeared in Section 337 of the Revenue Act of 1938, c. 289, 52 Stat. 447, and in Section 337 of the Internal Revenue Code.

Provision was made in Section 128 of the Revenue Act of 1942 for allowing tenant-stockholders of cooperative apartment corporations to deduct from their gross income that portion of payments to the corporation representing its taxes and interest.

tention here the taxpayer relies in part on the same authority advanced by the taxpayer there—*Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71.

Neither of these cases, it should be noted, held any corporation a nontaxable entity. The issue presented in both was whether post-1913 dividends to the taxpayer corporation from the pre-1913 earnings of wholly owned subsidiaries were to be regarded as income accruing to the taxpayer after 1913. The decision was that in view of the taxpayers' integration with their wholly owned subsidiaries, the income accrued to the former before the 1913 tax date. In the opinions in those cases and in *Burnet* v. *Commonwealth Imp. Co., supra,* at pp. 419–420, this Court has made it abundantly clear that these cases rest on their peculiar facts and do not support the general proposition that a wholly owned corporation and its owner are identical for tax purposes.

The peculiar fact which was the basis for those decisions sharply limits their significance. This Court was of the view that Congress, in the Income Tax Act of 1913, had made clear its intention that no income earned and available to a taxpayer prior to 1913 should be taxed as income accruing thereafter. Cf. *Lynch* v. *Turrish,* 247 U. S. 221, with *Peabody* v. *Eisner,* 247 U. S. 347. It was this view of the expressed will of Congress that dictated assimilation of wholly owned subsidiaries to the parent corporation in determining

when income accrued. Thus these decisions, at most, only stand for the proposition that wholly owned corporations may be identified with their owners for tax purposes when required to effectuate an expressed Congressional policy. See *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 442.

This Court's recent decision in *Higgins* v. *Smith*, 308 U. S. 473, is pertinent. The issue there was whether the taxpayer, an individual, had sustained a deductible loss on a sale of securities to his wholly owned corporation, formed in part to secure tax advantages and whose business was largely restricted to buying and selling securities to him. In the course of the opinion holding that the asserted loss was not deductible reference was made to the opinion in *Burnet* v. *Commonwealth Imp. Co.*, *supra*, and the observation made that pp. 477–478)—

> In the *Commonwealth Improvement Company* case, the taxpayer, for reasons satisfactory to itself voluntarily had chosen to employ the corporation in its operations. A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation, he must accept the tax disadvantages.
>
> On the other hand, the Government may not be required to acquiesce in the taxpayer's election of that form for doing business which is most advantageous to him. The Government may look at actualities and upon determination that the

> form employed for doing business or carrying out the challenged tax event is unreal or a sham may sustain or disregard the effect of the fiction as best serves the purposes of the tax statute. To hold otherwise would permit the schemes of taxpayers to supersede legislation in the determination of the time and manner of taxation. It is command of income and its benefits which marks the real owner of property.

In accordance with this pronouncement, and the decision of the case, if the corporate form employed for doing business is unreal or a sham the Commissioner may disregard it in fixing income tax liability "as best serves the purposes of the tax statute". If this should mean that in any case a corporation is relieved from liability for the tax levied by Section 13, it is only another instance where that happens as an incident to effectuating an overriding Congressional policy, i. e., that mere form of organization shall not be permitted to operate so as to promote tax avoidance.[8] Even though the corporation be inactive, however, there is no recognized or identifiable policy of Congress that requires its exemption from taxation under the broad language of Section 13 where its taxation has no adverse effect on the public revenue. Indeed, when the tax saving feature is absent

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[8] See Section 45 of the Revenue Acts of 1934 and 1936.

the only applicable Congressional policies are: (1) That expressed in Section 13, i. e., that every corporation shall pay a tax on its income; (2) that expressed in Section 117 (a), i. e., that capital gains shall be fully taxable when realized by corporations, and (3) that expressed in Section 141 (d) (3), Revenue Acts of 1934 and 1936, strictly limiting consolidated returns to railroad carriers.[9]

There are no prior decisions of this Court that hold a corporation is exempt from income taxation because of the insubstantial character of its activities or the fact that it has but one stockholder.[10] As seen above, such an argument was made and rejected in *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415. To refuse, in construing Section 13, to assimilate a wholly-owned corporation to its owner is, moreover, in harmony with decisions recognizing the corporate entity

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[9] For discussion, at some length, of the legislative history underlying the consolidated return provision, see brief for the respondent in *Interstate Transit Lines* v. *Helvering*, No. 552, present Term, now pending before this Court.

[10] A number of Circuit Court of Appeals decisions disregarding the corporate entity for other tax purposes did so in order to effectuate an expressed Congressional policy that was regarded as requiring such veil piercing. Explainable on this basis are *Munson S. S. Line* v. *Commissioner*, 77 F. 2d 849 (C. C. A. 2d); *Continental Oil Co.* v. *Jones*, 113 F. 2d 557 (C. C. A. 10th), certiorari denied, 311 U. S. 687; and *Inland Development Co.* v. *Commissioner*, 120 F. 2d 986 (C. C. A. 10th). With this last case, cf. *Texas-Empire Pipe Line Co.* v. *Commissioner*, 127 F. 2d 220 (C. C. A. 10th).

in interpreting other provisions of the Revenue Acts. *Dalton* v. *Bowers,* 287 U. S. 404 (loss by a wholly-owned corporation cannot be deducted by the owner on his individual return); *Burnet* v. *Clark,* 287 U. S. 410 (similar); *New Colonial Co.* v. *Helvering,* 292 U. S. 435 (successor corporation cannot have the benefit of losses of its predecessor). Cf. *Groman* v. *Commissioner,* 302 U. S. 82, 89; *Helvering* v. *Bashford,* 302 U. S. 454, 458.

Nor is a literal construction of Section 13 productive of injustice or oppression. The provision for taxation is there for all to heed as an incident to incorporation for business ventures. As stated in *Higgins* v. *Smith, supra* (p. 477):

> A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do some business as a corporation he must accept the tax disadvantages.[11]

To similar effect see *Gray* v. *Powell,* 314 U. S. 402, 414. Cf. *Edwards* v. *Chile Copper Co.,* 270 U. S. 452, 456.

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[11] For Circuit Court decisions applying this principle announced in *Higgins* v. *Smith, supra,* see *Esmond Mills* v. *Commissioner,* 132 F. 2d 753 (C. C. A. 1st); *Palcar Real Estate Co.* v. *Commissioner,* 131 F. 2d 210 (C. C. A. 8th); *Vim Securities Corp.* v. *Commissioner,* 130 F. 2d 106 (C. C. A. 2d), certiorari denied, December 7, 1942, No. 508, present Term; *Texas-Empire Pipe Line Co.* v. *Commissioner,* 127 F. 2d 220 (C. C. A. 10th); *Salmon* v. *Commissioner,* 126 F. 2d 203 (C. C. A. 2d); *Watson* v. *Commissioner,* 124 F. 2d 437 (C. C. A. 2d).

The construction contended for eases the task of administration and, from the taxpayer's viewpoint, eliminates the hazard of uncertainty in business affairs and the expense of litigation. Altogether the wisdom of Congress in taxing the income of every corporation and the essential fairness of so doing is clearly apparent.

Under this construction of Section 13 the only question remaining is whether the income in question was that of the taxpayer. Petitioner's brief is largely directed to this issue and it earnestly contends that the taxpayer acted as a mere agent or fiduciary for its stockholder so that the income in question was not its income at all.[12] The issue raised is clearly one of law for the facts respecting the taxpayer's relation with Thompson are not in dispute. The only question is whether as a legal matter, on the basis of that relation, the taxpayer is taxable on the gain from the sale by it of the property to which it held title as owner or whether, as the Board of Tax Appeals held, the taxpayer should be disregarded to effect "a more realistic assessment of taxes." (R. 21.) This was no more than a legal conclusion that the taxpayer's inactivity and its identity of interest with Thompson exempted it from the tax levied by Section 13.

That a corporation may act as an agent for its

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[12] The agency argument is not predicated upon any contractual relationship with Thompson. If he had sold his stock, the claimed agency relationship would then have been with the purchaser.

sole stockholder if the transaction is cast in that mold may be conceded. In such a case the benefits and the burdens of principalship remain with the stockholder. Here, however, it cannot be contended that the taxpayer was designated by Thompson to act as his agent or that the taxpayer purported to act as agent, trustee, or mere conduit in any of the income-producing transactions. On the contrary, the undisputed facts make clear that the beneficial interest of Thompson in the property sold had been designedly relegated to that of a stockholder and that there is no basis for any "agency" argument.

Title to realty in Block 77 in 1928 was in Thompson and he was about to lose the property for delinquent taxes. The property was mortgaged to one bank and its affiliate proposed to lend the money to pay the back taxes if a corporation was formed to hold title to the property and Thompson pledged all its stock as collateral for the loan. To this Thompson agreed, and in accordance with his decision the taxpayer was created for this obviously proper business purpose. Title to Block 77 was conveyed to the taxpayer and the taxpayer's stock was pledged to the bank. It was of the essence of the plan that the corporation succeed Thompson as the owner of the land.[13] To categorize the taxpayer as a

[13] Thompson owned other real property in his own name (R. 19) and the segregation of Block 77 in the Moline corporation insulated that property from Thompson's general creditors.

"dummy" or a "figmentary agent" and identify it with Thompson would conflict directly with the reason for its creation. Cf. *Sheldon Bldg. Corp.* v. *Commissioner,* 118 F. 2d 835, 837 (C. C. A. 7th).

When the taxpayer was first organized, Thompson had no control over it (cf. *New Colonial Co.* v. *Helvering, supra,* p. 441), and even after the voting trust agreement was terminated in 1933 he was simply in the position of a person taking over the stock of a corporation already organized and functioning. After the settlement of the $6,750 loan from Biscayne and the payment of the two mortgages in 1933 the taxpayer continued its corporate existence. (R. 18–19.) In 1934 it received income from renting a portion of its property (R. 19). Some time prior to termination of the creditor control of the taxpayer an action was instituted to remove certain restrictions imposed on Block 77 by a prior deed and this action did not terminate until 1936 (R. 18, 41, 54). The taxpayer was also involved in a condemnation proceeding during this period (R. 18). The property owned by the corporation was sold in three parcels, one in 1934, one in 1935, and one in 1936 (R. 19). Some of the proceeds from the sale of property in 1936 were used to pay the loan authorized by the taxpayer and secured by a mortgage on its property, as well as accumulated taxes against the property (R. 18, 41). Finally,

it may be noted, the sales made in 1934 [14] and 1935 were reported by the taxpayer on its returns (R. 19).

In the face of these facts it is clear that the taxpayer was a real corporation for the tax years in question, serving a business purpose, and one doing business in its own right. That the taxpayer kept no accounts, that it may have subserved directly the interest of its sole stockholder on occasion, and that he on some occasions may have disregarded the legal separation of his corporate from his natural self,[15] is not remarkable in light of the fact that the taxpayer was a wholly-owned corporation. The gains and losses for the tax years involved resulted from the sale by the taxpayer of lands owned by it. The income therefrom was therefore that of the taxpayer. Had Thompson desired the taxpayer to act as his agent and be so regarded by the world, such elaborate

[14] The 1934 sale resulted in a loss and it was not advantageous to shift it to Thompson's individual return, since his deduction would have been limited by Section 117 (a) and (d) of the Revenue Act of 1934. Only the years 1935 and 1936 are involved here.

[15] In fact, there was considerable respect for the corporate entity on the part of those dealing with it. With respect to the 1936 sale, the purchaser refused to make the check for the purchase price payable to anyone but the taxpayer. Thompson, as president of the taxpayer, endorsed the check. He offered it for deposit in his account but the bank refused to accept it until Thompson furnished a corporate resolution consenting to that being done. (R. 50–51.) Moreover, as seen above, a substantial number of transactions took place where the taxpayer appeared as principal.

precaution should not have been taken to relegate his interest in the property sold to that of stockholder rather than principal.

The argument that a corporation that has performed the functions of the taxpayer can disavow its responsibility for tax purposes when business has been done in the corporate name, clearly would preclude, as a practical matter, the construction of Section 13 contended for above. If corporate responsibility can be disclaimed for tax purposes on an agency theory where the corporation has acted as principal, then the tax levied by Section 13 is not the price of doing business as a corporation. In most one-man corporations quite as strong an agency argument can be made as is advanced here. Its acceptance would mean in net result the exemption of a large class of corporations from the tax levied by Section 13, and that Congress did not intend.

Actually, the contention that a corporation that has acted as principal is a mere conduit or agent for its stockholder is but another way of articulating the contention that a wholly-owned corporation engaging in little activity should not be recognized as a legally responsible entity, i. e., that the corporate entity should be disregarded. Respecting the corporate entity in the case of a wholly-owned corporation means, of course, that the corporation is recognized as the legally responsible entity as distinguished from its stock-

holder. Hence, respecting the entity and treating the corporation as a mere figmentary agent for the stockholder are irreconcilable opposites. However the argument here is phrased the issue is the same. Do the facts that the corporation has but one stockholder, that it represents his business interests in its transactions, and that on occasion he may naturally intermingle his individual and corporate activities, compel the conclusion that Congress did not intend the tax levied by Section 13 to apply to such a corporation with respect to business done in its name as principal?

If, as contended, Section 13 is to be construed as imposing a tax on the use of the corporate device, the answer is clear.

The agency argument was addressed to this Court and rejected in *Burnet* v. *Commonwealth Imp. Co., supra.* There the wholly-owned corporation merely held securities formerly owned by its sole stockholder for the dual purpose of avoiding multiple death duties or transfer taxes and to safeguard an endowment which its owner wished to make to a favorite charity. The corporation's only activity, referred to in the opinion, apart from holding title to these securities, was to purchase some stock by virtue of stock rights it had and to sell stock held by it to its stockholder. This Court held that it was taxable on the gain realized on the sale of this stock to its only stockholder. In rejecting the

contention that the corporate entity should be disregarded *or* that the taxpayer should be regarded as "merely the agency or the instrumentality" of the stockholder, this Court observed (pp. 419–420):

> Certainly, the Improvement Company and the Estate were separate and distinct entities; the former was avowedly utilized to bring about a change in ownership beneficial to the latter. For years they were recognized and treated as different things and taxed accordingly upon separate returns. The situation is not materially different from the not infrequent one where a corporation is controlled by a single stockholder. * * *.

This decision, in light of the contention there made, is a clear recognition that the entity and agency arguments in such a case as this are one and the same. The later expression in *Higgins* v. *Smith, supra*, represents further recognition that it is not the Commissioner's task to examine minutely corporate-stockholder relations in applying Section 13.

For the same reason that the taxpayer is subject to Section 13, it is taxable on the income from the sale of its property, i. e., the transactions were carried out as corporate business and the tax consequence of so clothing the transactions

must be accepted. Nor is the rule one-sided, for it was for Thompson to decide, in the first instance, whether the advantages and disadvantages of incorporation should be assumed.

The decisions relied on by the taxpayer as establishing the rule that a corporation that functioned as it did must be regarded as a mere agent cannot be regarded as authoritative. The cited cases do not establish any distinction between the "agency" doctrine and outright disregard of the corporate entity. As seen above, such a distinction is mere verbalism. However phrased, the issue is whether the corporation is to be treated as a taxpayer and taxed on the income from its transactions.

The decisions of the Board of Tax Appeals cited as establishing an independent rule of law with reference to the tax status of corporations in fact involve many different types of situations. Some of the Board's decisions holding a corporation nontaxable on income from the sale of property to which it held title have been based on the fact that the conveyance to the corporation in the first instance was one of several contemporaneous documents that established that the corporation took title only as agent or trustee. In such a case it may be observed that the beneficial owners forswear many of the advantages of having their

business done as corporate business.[16] That was not the case here. Another decision of the Board was based on the assumption that local law determines whether a corporation is taxable on sales made of its property.[17] Other Board decisions cited rest on the erroneous construction of this Court's decision in *Southern Pacific Co.* v. *Lowe*, *supra*, contended for by the taxpayer here.[18]

The later Board decisions holding corporations nontaxable have relied principally on the Circuit Court decisions in *112 West 59th Street Corp.* v. *Helvering*, 68 F. 2d 397 (App. D. C.), and *North Jersey Title Ins. Co.* v. *Commissioner*, 84 F. 2d 898 (C. C. A. 3d), also cited by the taxpayer. The first of these cases reversed a decision of the Board of Tax Appeals and held a corporation nontaxable on income from the sale of property to which it had held title for upwards of two years, as an aid to conveyance on sale during the absence of an interested party. The decision was based on the ground that the beneficial interest

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[16] See *Forshay* v. *Commissioner*, 20 B. T. A. 537; *Moro Realty Holding Corp.* v. *Commissioner*, 25 B. T. A. 1135.

[17] *Thrift Realty Co.* v. *Commissioner*, 29 B. T. A. 545. It may be noted that *McInerney* v. *Commissioner*, 29 B. T. A. 1, affirmed, 82 F. 2d 665 (C. C. A. 6th), involved disregard of the corporate entity at the Commissioner's behest; hence it is not relevant here.

[18] In this connection see *Mayer* v. *Commissioner*, 36 B. T. A. 117, and *Abrams Sons' Realty Corp.* v. *Commissioner*, 40 B. T. A. 653.

in the property was in the stockholders and some emphasis was placed on local law in arriving at this result.

In *North Jersey Title Ins. Co.* v. *Commissioner, supra,* a corporation organized by an insurance company to manage and salvage as much as possible from certain property for the insurance company was held not to constitute a taxable entity, reversing the decision of the Board. The basis for the Circuit Court decision was the same misconstruction of *Southern Pacific Co.* v. *Lowe, supra,* urged here by the taxpayer and analyzed above.

Many of the decisions of the Board cited by the taxpayer are distinguishable on their facts from the case here presented. In so far as relavant they, together with the two Circuit Court decisions referred to above, assert on the basis of local property law or a misconstruction of this Court's decision in *Southern Pacific Co.* v. *Lowe* that the taxability of a corporation on income from sale of its property depends on the amount of corporate activity and ownership of the corporate stock. These cases in principle, therefore, conflict with this Court's decisions in *Burnet* v. *Commonwealth Imp. Co., supra,* and *Higgins* v. *Smith, supra,* as well as the expressed will of Congress as explained above.

The other decision relied on by the taxpayer is that of *United States* v. *Brager Building & Land*

Corp., 124 F. 2d 349 (C. C. A. 4th). There certain property was under a long-term lease in which the owners, a partnership, had provided that the rentals should be paid by the lessee directly to a trustee for payment of a debt secured by a mortgage on the property. Subsequently the property was conveyed to a corporation and a tax was assessed against it on the basis of the rental payments described. The Circuit Court held that under these circumstances, where the corporation did no more than hold title to realty, the corporation was not taxable on the rental income. Clearly the case is distinguishable from that here presented. Indeed, it appears that the court that decided it would not follow it here, see *American Package Corp.* v. *Commissioner,* 125 F. 2d 413, 415 (C. C. A. 4th). In so far, however, as the decision in *United States* v. *Brager Building & Land Corp., supra,* is based on the proposition that a corporation is not taxable on income from property held by it, when there is nothing more than the ownership of stock and corporate inactivity to support an "agency," the doctrine announced cannot be accepted. Such a rule of law is not compatible with the proposition that one of the prices of corporate existence is payment of the tax levied by Section 13.

In contrast with the decisions relied on by the taxpayer, reference may be made to the decisions

in *Palcar Real Estate Co.* v. *Commissioner*, 131 F. 2d 210 (C. C. A. 8th), and *Sheldon Bldg. Corp.* v. *Commissioner*, 118 F. 2d 835 (C. C. A. 7th), where on comparable facts the corporations were held to be taxpayers rather than ephemeral agents.

Even if it be assumed that there is a species of corporations of such low estate as to be exempt from taxation under Section 13, it seems clear that the taxpayer does not fall in that group. It is often stated that as a general rule a corporation and its stockholders are separate entities for taxation as well as other purposes. *Klein* v. *Board of Supervisors*, 282 U. S. 19; *Dalton* v. *Bowers, supra*; *Burnet* v. *Clark, supra*; *New Colonial Co.* v. *Helvering, supra*; *Burnet* v. *Commonwealth Imp. Co., supra*. Whatever the scope of any exception to the general rule for purposes of Section 13, it most certainly does not embrace corporations formed for recognized business purposes that proceed to fulfill their functions.[19] *Burnet* v. *Commonwealth Imp. Co., supra*; *Higgins* v. *Smith, supra*.

From the facts as developed hereinbefore it is clear that the taxpayer was formed for a business

[19] See Finkelstein, *The Corporate Entity and the Income Tax* (1935), 44 Yale L. J. 436, 452, *et seq.*; Harrar, *The Function of the Entity in Federal Income Taxation: Recent Developments* (1940), 25 Minn. L. Rev. 189, 194; Ballantine, *Corporate Personality in Income Taxation* (1921), 34 Harv. L. Rev. 573.

purpose and fulfilled business functions. It is therefore clearly taxable on the income resulting from the sale of its property.

CONCLUSION

The judgment below should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 660.—October Term, 1942.

Moline Properties, Inc., Petitioner, *vs.* Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[June 1, 1943.]

Mr. Justice Reed delivered the opinion of the Court.

Petitioner seeks to have the gain on sales of its real property treated as the gain of its sole stockholder and its corporate existence ignored as merely fictitious. Certiorari was granted because of the volume of similar litigation in the lower courts and because of alleged conflict of the decision below with other circuit court decisions.[1] — U. S. —.

Petitioner was organized by Uly O. Thompson in 1928 to be used as a security device in connection with certain Florida realty owned by him. The mortgagee of the property suggested the arrangement, under which Mr. Thompson conveyed the property to petitioner, which assumed the outstanding mortgages on the property, receiving in return all but the qualifying shares of stock, which he in turn transferred to a voting trustee appointed by the creditor. The stock was to be held as security for an additional loan to Mr. Thompson to be used to pay back taxes on the property. Thompson owned other real property, title to which he held individually. In 1933 the loan which occasioned the creation of petitioner was repaid and the mortgages were refinanced with a different mortgagee; control of petitioner reverted to Mr. Thompson. The new mortgage debt was paid in 1936 by means of a sale of a portion of the property held by petitioner. The remaining holdings of the petitioner were sold in three par-

[1] 112 West 59th Street Corp. v. Helvering, 68 F. 2d 397; United States v. Brager Building & Land Corp., 124 F. 2d 349; North Jersey Title Ins. Co. v. Commissioner, 84 F. 2d 898; Inland Development Co. v. Commissioner, 120 F. 2d 986; see The Carling Holding Co. v. Commissioner, 41 B. T. A. 493; Mayer v. Commissioner, 36 B. T. A. 117; Abrams Sons' Realty Corp. v. Commissioner, 40 B. T. A. 653; Thrift Realty Co. v. Commissioner, 29 B. T. A. 545; Moro Realty Holding Corp. v. Commissioner, 25 B. T. A. 1135, affirmed 65 F. 2d 1013; Forsbay v. Commissioner, 20 B. T. A. 537.

cels, one each in 1934, 1935 and 1936, the proceeds being received by Mr. Thompson and deposited in his bank account.

Until 1933 the business done by the corporation consisted of the assumption of a certain obligation of Thompson to the original creditor, the defense of certain condemnation proceedings and the institution of a suit to remove restrictions imposed on the property by a prior deed. The expenses of this suit were paid by Thompson. In 1934 a portion of the property was leased for use as a parking lot for a rental of $1,000. Petitioner has transacted no business since the sale of its last holdings in 1936 but has not been dissolved. It kept no books and maintained no bank account during its existence and owned no other assets than as described. The sales made in 1934 and 1935 were reported in petitioner's income tax returns, a small loss being reported for the earlier year and a gain of over $5,000 being reported for 1935. Subsequently, on advice of his auditor, Thompson filed a claim for refund on petitioner's behalf for 1935 and sought to report the 1935 gain as his individual return. He reported the gain on the 1936 sale.

The question is whether the gain realized on the 1935 and 1936 sales shall be treated as income taxable to petitioner, as the Government urges, or as Thompson's income. The Board of Tax Appeals held for petitioner on the ground that because of its limited purpose the corporation "was a mere figmentary agent which should be disregarded in the assessment of taxes." *Moline Properties, Inc. v. Commissioner*, 45 B. T. A. 647. The Circuit Court of Appeals reversed on the ground that the corporate entity, chosen by Thompson for reasons sufficient to him, must now be recognized in the taxation of the income of the corporation. *Commissioner v. Moline Properties, Inc.*, 131 F. 2d 388.

The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation[2] or to avoid[3] or to comply with the demands of creditors[4] or to serve the creator's personal or undisclosed convenience,[5] so long as that purpose is the equivalent of

2 Texas Empire Pipe Line Co. *v.* Commissioner, 127 F. 2d 220. Cf. Edwards *v.* Chile Copper Co., 270 U. S. 452, 453-4, 456.

3 Sheldon Bldg. Corp. *v.* Commissioner, 118 F. 2d 835.

4 Palcar Real Estate Co. *v.* Commissioner, 131 F. 2d 210.

5 Watson *v.* Commissioner, 124 F. 2d 437; Salmon *v.* Commissioner, 126 F. 2d 203.

business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 442; *Deputy* v. *du Pont*, 308 U. S. 488, 494. In *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415, this Court appraised the relation between a corporation and its sole stockholder and held taxable to the corporation a profit on a sale to its stockholder. This was because the taxpayer had adopted the corporate form for purposes of his own. The choice of the advantages of incorporation to do business, it was held, required the acceptance of the tax disadvantages.

To this rule there are recognized exceptions. *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn*, 248 U. S. 71, have been recognized as such exceptions but held to lay down no rule for tax purposes. *New Colonial Co.* v. *Helvering*, *supra*, 442, n. 5; *Burnet* v. *Commonwealth Imp. Co.*, *supra*, 419, 420. A particular legislative purpose, such as the development of the merchant marine whatever the corporate device for ownership, may call for the disregarding of the separate entity, *Munson S. S. Line* v. *Commissioner*, 77 F. 2d 849, as may the necessity of striking down frauds on the tax statute, *Continental Oil Co.* v. *Jones*, 113 F. 2d 557. In general, in matters relating to the revenue, the corporate form may be disregarded where it is a sham or unreal. In such situations the form is a bald and mischievous fiction. *Higgins* v. *Smith*, 308 U. S. 473, 477-78; *Gregory* v. *Helvering*, 293 U. S. 465.

The petitioner's corporation was created by Thompson for his advantage and had a special function from its inception. At that time it was clearly not Thompson's *alter ego* and his exercise of control over it was negligible. It was then as much a separate entity as if its stock had been transferred outright to third persons. The argument is made by petitioner that the force of the rule requiring its separate treatment is avoided by the fact that Thompson was coerced into creating petitioner and was completely subservient to the creditors. But this merely serves to emphasize petitioner's separate existence. *New Colonial Co.* v. *Helvering*, *supra*, 441. Business necessity, i. e., pressure from creditors, made petitioner's creation advantageous to Thompson.

When petitioner discharged its mortgages held by the initial creditor and Thompson came into control in 1933, it was not dissolved, but continued its existence, ready again to serve his business interests. It again mortgaged its property, discharged that

new mortgage, sold portions of its property in 1934 and 1935 and filed income tax returns showing these transactions. In 1934 petitioner engaged in an unambiguous business venture of its own—it leased a part of its property as a parking lot, receiving a substantial rental. The facts, it seems to us, compel the conclusion that the taxpayer had a tax identity distinct from its stockholder.

Petitioner advances what we think is basically the same argument of identity in a different form. It urges that it is a mere agent for its sole stockholder and "therefore the same tax consequences follow as in the case of any corporate agent or fiduciary." There was no actual contract of agency, nor the usual incidents of an agency relationship. Surely the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders. Therefore the question of agency or not depends upon the same legal issues as does the question of identity previously discussed. *Burnet* v. *Commonwealth Imp. Co.*, *supra*, 418, 419-20.

Affirmed.